United States Board of Tax Appeals.

DOCKET NO. 79424.

CLARENCE M. FREEDMAN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Appearances:
For Taxpayer: JOHN W. TOWNSEND, ESQ.;
For Comm'r: R. N. MCMILLAN, ESQ.

DOCKET ENTRIES.

May 9, 1935.	Petition received and filed. Taxpayer notified. (Fee paid).
May 9, 1935.	Copy of petition served on General Counsel.
June 15, 1935.	Answer filed by General Counsel.
June 20, 1935.	Copy of answer served on taxpayer.
Sept. 28, 1935.	Hearing set Nov. 11, 1935.
Nov. 1, 1935.	Notice of appearance of John W. Townsend, as counsel for taxpayer filed.
Nov. 1, 1935.	Motion for continuance to 11/21/35 filed by taxpayer. 11/4/35 granted.
Nov. 21, 1935.	Hearing had before Mr. Arundell, Div. 7 on merits. Briefs due as per rules.

Dec. 2, 1935.	Transcript of hearing of Nov. 21, 1935 filed.
Jan. 6, 1936.	Request for findings of fact and brief filed by taxpayer. 1/7/36 copy served.
Feb. 4, 1936.	Brief filed by General Counsel.
Feb. 19, 1936.	Reply brief filed by taxpayer. 2/20/36 copy served.
Aug. 19, 1936.	Findings of fact and opinion rendered, Mr. Arundell, Div. 7. Decision will be entered for the Commissioner.
Aug. 21, 1936.	Decision entered, Mr. Arundell, Div. 7.
Sept. 4, 1936.	Motion for review by the Board filed by taxpayer.
Sept. 8, 1936.	Order denying Board review entered.
Nov. 17, 1936.	Petition for review by U. S. Circuit Court of Appeals (3) with assignments of error filed by taxpayer.
Nov. 17, 1936.	Proof of service filed.
Dec. 16, 1936.	Stipulation to correct transcript filed.
Dec. 16, 1936.	Agreed statement of evidence approved and ordered filed.
Dec. 16, 1936.	Agreed præcipe filed.

PETITION.

(Filed May 9, 1935.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 79424.

Clarence M. Freedman,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency IT:AR;B-1, dated February 12, 1935, and as a basis of his proceeding alleges as follows:

1. The petitioner is a member of the Bar of Philadelphia County in the State of Pennsylvania, residing at 5323 Diamond Street, in the City of Philadelphia (formerly resided at 5307 Berks Street, Philadelphia).

2. The notice of deficiency, a copy of which is attached and marked Exhibit A, was mailed to the petitioner on February 12, 1935.

3. The taxes in controversy are the salary of the petitioner as an assistant attorney in the Department of Justice of the Commonwealth of Pennsylvania, assigned to the Department of Banking of the Commonwealth of Pennsylvania for the year 1932, and for the sum of $142.70.

4. The determination of tax set forth in the said notice of deficiency is based upon the following errors:

1. The tax is assessed against his salary as an employee of the Department of Justice of the Commonwealth of Pennsylvania, which said salary petitioner alleges is properly exempt from Federal income tax.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

1. The petitioner was an employee of the Commonwealth of Pennsylvania.

2. His position was specifically created by a statute of the Commonwealth of Pennsylvania.

3. His tenure of office, his compensation and his duties were fixed by law.

4. He was at all times subject to the direction and control of the Attorney General of the Commonwealth of Pennsylvania, the officer who appointed him.

5. To subject his salary to the Federal income tax would so burden the State as to constitute an interference through taxation by the Federal Government of the discharge by the Commonwealth of Pennsylvania of an essential governmental function.

WHEREFORE your petitioner prays that this Board may hear the proceeding and reverse the action of the Commissioner of Internal Revenue in assessing the deficiency hereinabove referred to.

CLARENCE M. FREEDMAN,
Petitioner.

STATE OF PENNSYLVANIA,
COUNTY OF PHILADELPHIA, } *ss.:*

CLARENCE M. FREEDMAN, being duly sworn according to law, deposes and says that he is the petitioner above named and that he is familiar with the statements contained herein, and that the facts stated are true and correct and that he believes that there is good ground for this petition and that the proceedings have not been instituted merely for delay.

CLARENCE M. FREEDMAN.

Sworn to and subscribed before me this seventh day of May, 1935.

C. ALMA SHEIP,
(Seal) *Notary Public.*
My commission expires January 24, 1937.

EXHIBIT A.

TREASURY DEPARTMENT
Washington

Feb 12, 1935.

Mr. Clarence M. Freedman,
5307 Berks Street,
Philadelphia, Pennsylvania.
Sir:

You are advised that the determination of your income tax liability for the year (s) 1932, discloses a deficiency of $142.70 as shown in the statement attached.

In accordance with section 272 (a) of the Revenue Act of 1932, as amended by section 501 of the Revenue Act of 1934, notice is hereby given of the deficiency mentioned. Within ninety days (not counting Sunday or a legal holiday in the District of Columbia

as the ninetieth day) from the date of the mailing of this letter, you may file a petition with the United States Board of Tax Appeals for a redetermination of the deficiency.

Should you not desire to file a petition, you are requested to execute the enclosed form and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency and will prevent the accumulation of interest, since the interest period terminates thirty days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

GUY T. HELVERING,
Commissioner.
By Chas. T. Russell
Deputy Commissioner.

Enclosures:
Statement
Form 870

STATEMENT

IT:AR:B-1
MCB-90D

In re: Mr. Clarence M. Freedman,
5307 Berks Street,
Philadelphia, Pennsylvania

INCOME TAX LIABILITY

Year	Income Tax Liability	Income Tax Assessed	Deficiency
1932	$205.39	$62.69	$142.70

Under date of December 11, 1934, a letter was mailed to you in which you were advised that the re-

view of your income tax return filed for the year 1932 in connection with the report of the internal revenue agent in charge, Philadelphia, Pennsylvania, disclosed a deficiency in tax of $142.70.

Under date of December 15, 1934, a letter was received from you in which it was intimated that the same issue was involved in the case of another attorney in your department assigned to bank liquidation work and that the decision in that case was still pending. No further information has been received. You are advised that this office holds that compensation received by you for services rendered to the Department of Banking of the Commonwealth of Pennsylvania must be included in gross income for Federal income tax purposes.

In order for the compensation received by an individual from a State or any political subdivision thereof to be exempt from Federal income tax it must be determined that it was received by him as an officer or employee of the State or political subdivision, and that to subject it to Federal income tax would so burden the State or political subdivision as to constitute an interference through taxation by the Federal Government with the discharge by the State or political subdivision of an essential governmental function.

General Counsel Memorandum #13488 published in Internal Revenue Bulletin XIII-35, page 9, provides that liquidation who are appointed to liquidate banks taken over by the State in Florida, whose compensation is paid from funds or assets of the bank being liquidated, are subject to Federal income tax.

In the case of Miller v. McCaughn (22 Fed. (2d) 165), the United States District Court, in holding that the compensation received by an auditor appointed by the Pennsylvania State Courts to report on the financial standing of corporations applying for approval as

sureties on bonds was not exempt from Federal income tax, stated:

> ". . . The compensation must not merely come to a State officer or employee, but it must come to him from the State to be exempt. Unless this second line is drawn and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the respondent might well be held to be such 'officer or employee' but in which the compensation does not come directly or indirectly from the State, otherwise than in the sense that he would not be in the enjoyment of it, were it not for the relation of officer or employee of the State which he enjoys.
>
> "Here what the plaintiff receives comes wholly from the surety companies upon whose financial resources he reports. . . ."

As stated above and in view of the foregoing it is held that the compensation received by you for services rendered to the Department of Banking of the Commonwealth of Pennsylvania must be included in gross income for Federal income tax purposes.

The original report of the internal revenue agent in charge, Philadelphia, Pennsylvania, covering an examination of your income tax liability for the year 1932, a copy of which was furnished you on June 8, 1934, has been reviewed and approved by this office. A synopsis of the return, as corrected, follows:

Net income reported on the return	$2,352.12
Plus:	
1. Salary	3,000.00
2. Bad debts disallowed as a deduction	141.50
3. Other deductions disallowed	73.75
Total net income as adjusted	$5,567.37

COMPUTATION OF TAX

Net income as adjusted		$5,567.37
Less:		
Personal exemption		1,000.00
Balance		$4,567.37
Normal tax at 4% on $4,000.00		$ 160.00
Normal tax at 8% on $567.37		45.39
Total tax assessable		$ 205.39
Tax previously assessed:		
Original	$54.08	
Additional	8.61	62.69
Deficiency in tax		$ 142.70

EXPLANATION OF CHANGES

1. This item has been explained above.

2. Bad debts of $141.50 have been disallowed, as a deduction for the reason that they have not been substantiated.

3. A deduction of $73.75 for maintenance and depreciation of auto used in business has been allowed. Since you claimed a deduction of $147.50, the amount of $73.75 has been restored to taxable income.

ANSWER.

(Filed June 15, 1935.)

The Commissioner of Internal Revenue, by his attorney, Robert H. Jackson, Assistant General Counsel for the Bureau of Internal Revenue, in answer to the petition of the above-named taxpayer, admits and denies as follows:

1 and 2. Admits the allegations contained in paragraphs 1 and 2 of the petition.

3. Admits that the taxes in controversy are for the year 1932, and for the sum of $142.70. Denies the remaining allegations contained in paragraph 3 of the petition.

4—1. Denies the errors alleged in paragraph 4-1 of the petition.

5—1 to 5, inclusive. Denies the allegations of fact set forth in subparagraphs 1 to 5 inclusive, of paragraph 5 of the petition.

Denies generally and specifically each and every allegation contained in the petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that petitioner's appeal be denied.

(Sgd.) ROBERT H. JACKSON,
Assistant General Counsel for the Bureau of Internal Revenue.

Of Counsel:

PAUL A. SEBASTIAN,
Special Attorney,
Bureau of Internal Revenue.

FINDINGS OF FACT AND OPINION.

(Rendered August 19, 1936.)

UNITED STATES BOARD OF TAX APPEALS.

DOCKET No. 79424. PROMULGATED AUGUST 19, 1936.

CLARENCE M. FREEDMAN,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Compensation received by petitioner for services rendered to the Department of Banking of Pennsylvania, *held,* not exempt from Federal income tax.

J. W. Townsend, Esq., for the petitioner.
R. N. McMillan, Esq., for the respondent.

This proceeding involves a deficiency in income tax for the year 1932 in the amount of $142.70. Only so much of the proposed deficiency is in controversy as arises from the respondent's addition to income of the sum of $3,000 received by the petitioner as compensation for services rendered to the Department of Banking of the Commonwealth of Pennsylvania. Petitioner contends that his compensation is exempt from tax on the ground that he was an employee of the commonwealth engaged in carrying on a governmental function.

FINDINGS OF FACT.

The petition is a lawyer, practicing his profession in Philadelphia, Pennsylvania. On October 2, 1931,

the attorney general of the Commonwealth of Pennsylvania directed to the petitioner a letter reading as follows:

> It gives me pleasure to appoint you an attorney in this Department assigned to the liquidation work of the Department of Banking. Your salary will be at the rate of $3,000.00 per annum.
>
> The Special Deputy Attorneys General who are assigned to this work in Philadelphia are being advised of your appointment and that you will be available to assist them in any way in which they may find it necessary to call upon you.

The petitioner accepted the appointment conferred by the above letter. He was thereafter continuously employed on matters relating to the liquidation of closed banks, as hereinafter more fully related, until March 9, 1935, when his employment was terminated on the occasion of a change in the political party in control of the state government, whereupon he was directed to turn his files over to his successor.

The department of justice and the department of banking are administrative divisions of the Commonwealth of Pennsylvania. The head of the department of justice is the attorney general and the head of the department of banking is the secretary of banking, these offices being provided for by statute. The attorney general has statutory power "to appoint and fix the compensation of Special Deputy Attorneys General and Special Attorneys to represent the Commonwealth, for any department, board, or commission thereof, in special work or in particular cases." Purdon's Penna. Stats., title 71, § 296. The secretary of banking is by statute given broad powers over banks within the commonwealth. When it appears to him that a bank is in an unsafe or unsound condition he may, after notice and hearing and with the consent of the attorney gen-

eral, take possession of the business and property of the bank; under certain conditions he may take possession without hearing and without the attorney general's consent. When he takes possession of a bank, he is vested with "all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonwealth"; while in possession of the bank he is "the representative of the creditors" thereof. The banking law provides that, in the case of banks the property of which is in the possession of the secretary of banking, all expenses in connection with such possession and of continuing the business or of liquidation "shall first be payable out of the funds of" such bank "including the compensation of special deputies, assistants, and others employed by the Secretary to assist him in such proceedings; the allowance of all such expenses to be subject to the approval of the Court." Purdon's Penna. Stats., title 7, §§ 29, 49.

The petitioner was assigned to work under special deputy attorneys general in Philadelphia County in connection with legal matters pertaining to closed banks in that county. Such closed banks were being liquidated by the secretary of banking pursuant to statute. The petitioner's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the banking department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and "in general anything that was assigned by the Special Deputy Attorney General at the time."

Such attorneys were considered by the department of justice as "available for any purpose at any time."

The petitioner handled legal matters for the state banking department in connection with the liquidation of the Northern Central Trust Co., the Darby Bank & Trust Co., the United States Bank & Trust Co., the Central Trust & Savings Co., the Mortgage Security & Trust Co., the Park Trust Co., and the Wharton Trust Co., among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County.

The particular work and the matters to which the petitioner gave attention were determined by the attorney general's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the attorney general's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the attorney general and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the attorney general.

The petitioner's duties and the manner in which they should be performed were prescribed in part by a large number of mimeographed circulars issued by the attorney general at Harrisburg at frequent intervals and sent to all attorneys handling closed bank matters. Also, his instructions were received periodically from a deputy attorney general at regular meetings held for

the purpose of discussing their problems and deciding on procedure.

The petitioner received no compensation for his services other than his $3,000 salary, but was reimbursed for his expenses. He was furnished with necessary office facilities. He was required to use official letterheads furnished by the department of justice, and signed his letters as "attorney" for the department of justice. The files in matters handled by him were considered the property of the state and were turned over by him to his successor when his employment was terminated. While the department of justice could have required all his time and had first call on his services, he was permitted to engage in private practice. In 1932 he spent more than 50 percent of his time on state business. He had to give up certain regular employment to accept the employment in the department of justice. His professional income for 1932, aside from the $3,000 salary, was $2,735.60. He was not a member of a law firm.

Petitioner's salary was paid to him semimonthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the secretary of banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks whose assets had been taken over by the secretary of banking, but later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the petitioner's salary was charged were determined by the attorney general and the secretary of banking. The salaries of attorneys handling matters relating to the several closed banks were ordinarily paid out of the funds of such banks in approximate proportion to the amount of work done for each bank.

Petitioner did not include in his income tax return for 1932 the $3,000 salary received as compensation for services rendered to the department of banking.

OPINION.

ARUNDELL: This case involves the application of the principle of immunity of state instrumentalities from Federal taxation. As Mr. Chief Justice Hughes puts it in *Willcuts v. Bunn,* 282 U. S. 216, 225:

> The familiar aphorism is "that as the means and instrumentalities employed by the General Government to carry into operation the powers granted to it are exempt from taxation by the States, so are those of the States exempt from taxation by the General Government". *Ambrosini v. United States,* 187 U. S. 1, 7.

Many of the recent cases involving this principle carefully point out, in juxtaposition with the statement of it, its limitations. "The limitation of this principle to its appropriate applications is also important to the successful working of the governmental system." *Willcuts v. Bunn, supra.* "It is a principle implied from the necessity of maintaining our dual system of government. . . . Springing from that necessity it does not extend beyond it." *Board of Trustees of the University of Illinois v. United States,* 289 U. S. 48, 59. "Of course, the reasons underlying the principle mark the limit of its range." *Indian Motocycle Co. v. United States,* 283 U. S. 570. "This Court, in drawing the line which defines the limits of the powers and immunities of state and national governments, is not intent upon a mechanical application of the rule that government instrumentalities are immune from taxation, regardless of the consequences to the operations of government." *Educational Films Corporation v. Ward,* 282 U. S. 379, 391.

The immunity question has many facets and in this case the parties are at odds on nearly all of them. They argue the questions of whether petitioner was either an officer or employee of the state; whether his services were rendered in connection with the exercise of an essential governmental function; the materiality of the source of his compensation; and whether the tax will result in any burden on the state.

Our conclusion, based on reasons hereinafter given,, is that the $3,000 compensation received by the petitioner in 1932 is not exempt from taxation by the Federal Government.

In the first place, we are not satisfied that petitioner can properly be classified as an employee of the Commonwealth of Pennsylvania. The facts are that in 1932 the petitioner, while appointed and supervised by the attorney general, was actually performing the duties of counsel for the liquidator for a group of banks in the Philadelphia area. The duties performed, as set out in the findings of fact, were those that would usually be performed by an attorney or receiver for insolvent corporations. These duties did not require all of his time, but left him free to follow his profession in private practice, which he did, resulting in income of $2,700 from outside sources. These considerations leave considerable doubt as to whether it can be said that petitioner was an employee of the commonwealth in the usually accepted sense of the term. His relation with the secretary of banking appears to be that of attorney and client rather than that of employee and employer.

The basic ground for denying the petitioner's claim to immunity from tax, however, is that the source of his income precludes any possibility of a burden on the state resulting from a tax thereon. We do not think it can seriously be urged that petitioner was com-

pensated by the state merely because his checks were issued by the officers of the state, as the fact is that both by statute and in actual practice the source of his compensation was the assets of the several banks in the process of liquidation. These assets were not public funds as are taxes; they were not susceptible of appropriation by the legislature for general public use; they were private property being administered by the secretary of banking in a fiduciary capacity. Therefore, if any burden falls elsewhere than on petitioner, it is on those banks or their creditors, for whose benefit the petitioner was acting, rather than on the state. We held in *Ned R. Harman,* 34 B. T. A. 654, that fees received by a statutory court reporter from litigants for transcripts of stenographic records are not exempt from tax because they are not paid by the state itself and no burden on the state was shown. Similarly, it has been held that the compensation of an auditor appointed by the Orphans' Court in Pennsylvania to report on the financial condition of corporations applying as sureties on bonds tendered to the court was taxable since it was paid out of deposits made by the surety companies for that purpose with the clerk of the court, and was not paid by the state itself. *Miller v. McCaughan,* 22 Fed. (2d) 165; affd., 27 Fed. (2d) 128. The District Court in that case pointed out that the "moneys paid are never in any sense public moneys" and held:

> The compensation must not merely come to a state officer or employee, but it must come to him from the state, to be exempt. Unless this second line is drawn, and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the recipient might well be held to be such "officer or employee," but in which the compensation does not come directly or indirectly from the state, otherwise

than in the sense that he would not be in the enjoyment of it, were not for the relation of officer or employee of the state which he enjoys.

The Circuit Court of Appeals for the Third Circuit, affirming the District Court, held that the taxpayer could not be regarded as an officer or employee of the state and also emphasized the lack of any burden on the state, saying:

> The exemption of state employees from federal income tax rests on the ground that the agencies the state employs in government should not be burdened by federal taxes, which would lessen the state's power to employ, and compel it to pay more for the services of its employees. But no such reason exists in the case of this examiner. No power of the state is crippled or lessened by his paying tax on his income. Neither the state nor the court pay Mr. Miller.

Following the Third Circuit in the *Miller* case, the Board, held, as one of the grounds for denying exemption in two cases decided by memorandum opinions, that no burden resulted to the state from taxation of compensation received from a source other than the state. *Robert S. Spangler,* Docket No. 46386 (1933); *Charles A. Roberts,* Docket No. 74214 (1934). In the *Spangler* case, the taxpayer was a "special attorney" appointed by the commissioner of banking of the State of Pennsylvania to represent him in the liquidation of a state bank and his compensation was paid out of the assets of the bank, and in the *Roberts* case the taxpayer was an attorney appointed by the superintendent of banks of the State of New York to assist in the liquidation of a trust company, his compensation being paid by the bank in liquidation. To the same effect see Mim. 3838, dated January 17, 1936, I. R. Bulletin XV, No. 5. Following the above cases it must be held here that the petitioner's compensation was not exempt from tax.

The petitioner advances the view that, once he has established himself to be an officer or employee of the state engaged in performing a governmental function, his immunity from Federal taxation is absolute, irrespective of the source of his compensation or of any other consideration. In view of the disposition that we have made of the petitioner's premise it is unnecessary to decide this matter, but it is worthy of brief note. The petitioner's contention is based on expressions in some of the cases to the effect that where the principle of immunity applies it is absolute and is not affected by the amount of tax or the extent of the resulting interference. Cf. *Indian Motocycle Co., supra.* This contention, often urged in tax cases, has its genesis in the apprehension expressed in *McCulloch v. Maryland,* 4 Wheat. 316, in the maxim that "The power to tax is the power to destroy." The cases quoted at the outset of this opinion establish that the courts are not stampeded into broadly granting exemption by the quotation of the *McCulloch* maxim. On the contrary, they inquire into all the facts and circumstances of the case. They inquire into whether an officer or employee is engaged in an essential governmental function, *Helvering v. Powers,* 293 U. S. 214; *Brush v. Commissioner,* —— Fed. (2d) ——; *Ohio v. Helvering,* 292 U. S. 360; whether the tax works any substantial interference with governmental functions, *Metcalf & Eddy v. Mitchell,* 269 U. S. 514; or whether it exerts but a remote influence, *Willcuts v. Bunn,* 282 U. S. 216; *Brush v. Commissioner, supra.* They also inquire, as we have here, into the source of the funds taxed, *Miller v. McCaughn, supra.* These cases indicate that the so-called rule of absolute immunity is not so broad in its application as is indicated by a literal reading of the words apart from the context of the case in which they are used. They also establish the right of inquiry into all

matters affecting petitioner's employment, including that of the source of the funds from which he receives his compensation.

In view of the conclusion we have reached we do not deem it necessary to discuss other arguments advanced.

Decision will be entered for respondent.

DECISION.

(Entered August 21, 1936.)

Pursuant to the determination of the Board, as set forth in its report promulgated August 19, 1936, it is

ORDERED and DECIDED: That there is a deficiency in income tax for the year 1932 in the amount of $142.70.

(Sgd.) C. ROGERS ARUNDELL,
Member.

PETITION FOR REVIEW AND ASSIGNMENT OF ERRORS.

(Filed November 17, 1936.)

IN THE UNITED STATES CIRCUIT COURT OF APPEALS,
FOR THE THIRD CIRCUIT.

B. T. A. DOCKET No. 79424.

Clarence M. Freedman,

Petitioner,

v.

Guy T. Helvering, Commissioner of Internal Revenue,
Respondent.

To the Honorable Judges of the United States Circuit Court of Appeals for the Third Circuit:

Now comes Clarence M. Freedman, by his attorney, John W. Townsend, and respectfully shows to the Court:

I. The petitioner on review, Clarence M. Freedman, is a citizen of the United States, a resident of Philadelphia, Pennsylvania, and an inhabitant of the judicial circuit of the United States Circuit Court of Appeals for the Third Circuit. He filed his Federal income tax return for the calendar year 1932 with the Collector of Internal Revenue for the First District of Pennsylvania, within said judicial circuit. The respondent, Guy T. Helvering, hereinafter referred to as the Commissioner, is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

H. The controversy involves the proper determination of the Federal income tax liability of petitioner for the calendar year 1932, the amount of taxes involved being approximately $142.70.

The petitioner is a lawyer, practicing his profession in Philadelphia, Pennsylvania. In October, 1931, the Attorney General of the Commonwealth of Pennsylvania appointed petitioner as an attorney in the Department of Justice of said Commonwealth, at a salary payable ot the rate of $3000 per annum, and assigned him to the liquidation work of the Department of Banking. Petitioner was thereafter continuously employed on matters relating to the liquidation of closed banks until March 9, 1935, when his employment was terminated on the occasion of a change of the party in the control of the state government.

Petitioner was an employee in the Department of Justice, and not an employee in nor responsible to the Department of Banking, these being separate and distinct administrative divisions of the Commonwealth of Pennsylvania. Petitioner's appointment was made pursuant to statutory authority authorizing the Attorney General to appoint and fix the compensation of attorneys employed to represent the Commonwealth in connection with the work of any department, board or commission.

The petitioner was assigned to work under Special Deputy Attorneys General in Philadelphia County, in connection with legal matters pertaining to closed banks in that county, although he was considered by the Department of Justice as "available for any purpose at any time". His services were rendered solely to the Commonwealth of Pennsylvania, and not to any private person or corporation.

The particular work and the matters to which the petitioner gave attention were determined by the Attor-

ney General's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the Attorney General's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the Attorney General and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the Attorney General. He was authorized to call on other attorneys similarly employed for assistance, and in turn was required to give assistance to them.

The petitioner's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the Banking Department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and "in general anything that was assigned by the Special Deputy Attorneys General at the time".

The petitioner handled legal matters for the Banking Department in connection with the liquidation of the Northern Central Trust Co., the Darby Bank & Trust Co., the United States Bank & Trust Co., the Cen-

tral Trust & Savings Co., the Mortgage Security & Trust Co., the Park Trust Co., and the Wharton Trust Co., among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County.

Petitioner received no compensation for his services other than his $3000 salary, but was reimbursed for his expenses. The obligation to pay him this salary was solely that of the state, and he looked to the state for its payment. His salary was paid to him semimonthly by checks drawn by representatives of the State Banking Department in charge of closed banks in Philadelphia, the checks being countersigned by the Secretary of Banking at Harrisburg. In the early part of 1932 his salary was charged against funds of three closed banks whose assets had been taken over by the Secretary of Banking, but later in the year it was charged against funds of four closed banks, although his services were not confined to matters relating to the affairs of those particular banks. The banks against which the petitioner's salary was charged were determined by the Attorney General and the Secretary of Banking.

Petitioner was furnished with necessary office facilities. He was required to use official letterheads furnished by the Department of Justice, and signed his letters as "attorney" for the Department of Justice. The files in matters handled by him were considered the property of the state and were turned over by him to his successor when his employment was terminated.

While the Department of Justice could have required all his time and had first call on his services, petitioner was permitted to engage in private practice. In 1932 he spent more than 50 percentum of his time on state business. He had to give up certain regular employment to accept the employment in the Department

of Justice. His professional income for 1932, aside from the $3000 salary, was $2735.60. He was not a member of a law firm.

Petitioner did not include his said $3000 salary in his 1932 Federal income tax return, the Commissioner having issued a ruling that same was not taxable. In his audit of such return the Commissioner included said salary in taxable net income, and accordingly determined a deficiency in income tax against the petitioner for the calendar year 1932 in the amount of $142.70. On February 12, 1935, pursuant to the provisions of Sec. 272 (a) of the Revenue Act of 1932, as amended by Sec. 501 of the Revenue Act of 1934, the Commissioner sent to petitioner, by registered mail, notice of said deficiency. Thereafter on May 9, 1935, petitioner filed an appeal from such notice of deficiency with the United States Board of Tax Appeals. A hearing before the Board on said appeal was held on November 21, 1935. On August 19, 1936, the Board promulgated its findings of fact and opinion, holding petitioner's said salary was taxable and affirming the Commissioner's determination. On August 21, 1936, the Board entered its final order of redetermination, deciding that there is a deficiency in petitioner's income tax for the year 1932 in the amount of $142.70.

III. Petitioner seeks a review of the Board's said decision of August 21, 1936, by virtue of the provisions of subdivision (a) of Sec. 1001 of the Revenue Act of 1926, as amended by Sec. 1101 of the Revenue Act of 1932.

IV. The petitioner on review says that in the record and proceedings before the United States Board of Tax Appeals, in its said opinion promulgated August 19, 1936, and in its said decision entered on August 21, 1936, manifest errors occurred to the prejudice

of the petitioner, and he asserts and assigns the following errors which he avers occurred:

1. The Board of Tax Appeals erred in holding that petitioner is liable for a deficiency of $140.72 in his 1932 income taxes.

2. The Board erred in holding that the $3000 salary received by petitioner in 1932, for services rendered as an attorney in the Department of Justice of the Commonwealth of Pennsylvania, is subject to taxation by the Federal Government.

3. The Board erred in failing to find that petitioner's services were rendered solely to the Commonwealth of Pennsylvania.

4. The Board erred in failing to find that the obligation to pay said salary to petitioner was solely that of the Commonwealth of Pennsylvania.

5. The Board erred in failing to find that the petitioner was a member of the legal staff of the Department of Justice of the Commonwealth of Pennsylvania and was responsible only to the officials of that Department.

6. The Board erred in failing to find that petitioner was authorized to call on other attorneys of the said Department of Justice, similarly employed, for assistance in legal matters turned over to him, and that he in turn was required to give assistance to them.

7. The Board's finding or holding that petitioner cannot properly be classified as having been an employee of the Commonwealth of Pennsylvania in the year 1932 is unsupported by any evidence.

8. The Board erred in failing to hold that petitioner was an employee of the Commonwealth of Pennsylvania during the year 1932.

9. The Board's finding or holding, if its opinion can be construed as so finding or holding, that the petitioner was employed by or was responsible to the Secretary of Banking of the Commonwealth of Pennsylvania is unsupported by any evidence.

10. The Board's finding or holding that petitioner's relation with said Secretary of Banking appears to be that of attorney and client is unsupported by any evidence.

11. The Board erred in failing to hold that the taxation of the compensation of an employee of a state is, in itself, a sufficient interference with the independence of and burden upon such state government as to invoke the rule of immunity.

12. The Board erred in holding that the source of the funds used by the Commonwealth of Pennsylvania to pay petitioner's said salary precludes any possibility of a burden on the state, resulting from a tax on said compensation.

13. The Board erred in failing to find that the petitioner was engaged in 1932 in the performance of usual governmental functions on behalf of the Commonwealth of Pennsylvania.

14. The Board erred in failing to hold that petitioner's immunity from Federal taxation in respect of his said salary is absolute, irrespective of the source of funds used in payment thereof, petitioner in 1932 having been a state employee engaged in performing usual governmental functions.

15. The Board erred in failing to find that the Department of Justice of Pennsylvania secured a ruling in 1933 from the Commissioner of Internal Revenue, holding that the salaries of attorneys employed as in the case of the petitioner were exempt from the

Federal income tax; that petitioner's return was examined by a Revenue Agent and petitioner advised by such agent that said salary was exempt; and that such rulings were subsequently reversed by the Commissioner.

WHEREFORE, the petitioner prays that the decision of the United States Board of Tax Appeals, entered in this proceeding on August 21, 1936, be reviewed by the United States Circuit Court of Appeals for the Third Circuit; that a transcript of record be prepared in accordance with the law and the rules of said court, and transmitted to the clerk of said court; and that appropriate action be taken to the end that the errors complained of may be corrected and reviewed by said court.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review,
1366 National Press Building,
Washington, D. C.

DISTRICT OF COLUMBIA, *ss.:*

JOHN W. TOWNSEND, being duly sworn, says that he is the attorney for the petitioner on review and as such is duly authorized to verify the foregoing petition for review; that he has read said petition and is familiar with the contents thereof; that said petition is true of his own knowledge, except as to the matters therein alleged on information and belief, and as to those matters he believes it to be true.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

Subscribed and sworn to before me this seventeenth day of November, 1936.

MARGUERITE G. DAVIS,
Notary Public, D. C.

NOTICE OF FILING PETTTION FOR REVIEW AND ASSIGNMENT OF ERRORS.

(Filed November 17, 1936.)

To Herman Oliphant, Esq.,
General Counsel for the Department of the Treasury,
Washington, D. C.

You are hereby notified that the petitioner on review in the above-entitled proceeding, did, on the seventeenth day of November, 1936, file with the clerk of the United States Board of Tax Appeals at Washington, D. C., a petition for the review, by the United States Circuit Court of Appeals for the Third Circuit, of the decision of the Board of Tax Appeals heretofore rendered in this proceeding. A copy of such petition for review and of the assignment of errors as filed is hereto attached and served upon you.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

Dated November 17, 1936.

Personal service of the above notice, together with a copy of the said petition for review and assignment of errors mentioned therein, is hereby acknowledged this seventeenth day of November, 1936.

HERMAN OLIPHANT,
Attorney for Respondent on Review.

STATEMENT OF EVIDENCE.

(Filed December 16, 1936.)

The above-entitled cause came on for hearing before HON. C. ROGERS ARUNDELL, Member of the United States Board of Tax Appeals, on November 21, 1935, JOHN W. TOWNSEND, ESQ., representing the petitioner and R. N. MCMILLAN, ESQ., representing the respondent. The following is a statement of all the evidence adduced at the hearing which is essential to the decision of the questions raised by the assignment of errors set out in the petition for review.

CLARENCE M. FREEDMAN, the petitioner herein, called as a witness in his own behalf, testified as follows:

I reside at 5323 Diamond Street, Philadelphia, Pennsylvania. I am a member of the bar of Philadelphia County and have practiced law seven years in Philadelphia County.

There was received in evidence as Petitioner's Exhibit 1 letter dated October 2, 1931, from William A. Schnader, the then Attorney General of the Commonwealth of Pennsylvania, directed to the petitioner, the material part of which is quoted in the Board's findings of fact.

I accepted the appointment made in such letter by writing to the Attorney General and advising him that I would be pleased to accept. I did not take an oath of office because I understood I was an employee of the Commonwealth of Pennsylvania and not an officer. Officers are the only ones required to take an oath of office. Employees are not. I served as an attorney in the Department of Justice pursuant to that appointment until March 9, 1935.

There was received in evidence as Petitioner's Exhibit 2 a letter dated March 7, 1935, from Charles J. Margiotti, Attorney General of Pennsylvania, directed to the petitioner, the material part of which reads as follows:

> "You are hereby notified that your services as attorney representing the Department of Banking will terminate as of March 9, 1935.
>
> Will you kindly turn over to Israel Finkelstein, who has been appointed to succeed you, all files and other data belonging to this Department which you have in your possession."

There was received in evidence as Petitioner's Exhibit 3 a letter dated January 12, 1935, directed to petitioner, from William A. Schnader, Attorney General, Department of Justice of Pennsylvania, the material part of which reads as follows:

> "Before I leave office as Attorney General I desire to thank you for the splendid cooperation which you have given me in the performance of your work as a member of the staff of the Department of Justice.
>
> I am satisfied that the depositors of closed banks have benefited to the extent of millions of dollars through the energetic, efficient and loyal services of our closed bank attorneys.
>
> The Commonwealth is indebted to everyone of them."

My employment was terminated by reason of the going out of office of the Attorney General and the appointment of my successor in office by Charles J. Margiotti, the new Attorney General, of a different political faith. My service as such attorney was continuous from October 2, 1931, to March 9, 1935. My salary remained the same throughout that period.

During the year 1932 I received $3000. as salary for such services. I did not include that amount in my tax return.

At this point witness identified his original 1932 income tax return which was received in evidence as Petitioner's Exhibit 4. So far as material to the issues raised by the assignment of errors such exhibit shows that petitioner reported the sum of $2735.60 as his income from business or profession; that he designated himself as a lawyer; and that there was not included in such return any amount received on account of the compensation involved in this proceeding.

My return was examined by a revenue agent. The first action was to advise me that the position of the Government was that my salary as attorney for the Department of Justice was taxable. We had a conference in Philadelphia. The authorities cited by me were checked. I took the matter up with the Department of Justice of Pennsylvania with the result that I was advised that my salary was exempt. Some time later on the Bureau here in Washington ruled against my contention. I don't think I filed a protest. I simply took an appeal after I was notified of the time in which I could take an appeal. Prior to the time I filed my return, and the reason I did not include my salary, was that the Department of Justice in Pennsylvania had taken the matter up with the Commissioner of Internal Revenue in Washington and had secured a ruling which was submitted to all attorneys in the form of a memorandum to the effect that our salaries were not taxable; and for that reason I did not include it.

There was received in evidence as Petitioner's Exhibit 5 a copy of the memorandum dated March 6, 1933, from the Department of Justice of Pennsylvania directed to all attorneys representing the Secretary of Banking in possession of closed banks and trust companies, quoting a copy of a letter addressed by W. T.

Sherwood, Acting Deputy Commissioner of Internal Revenue, to Special Deputy Attorney General Shippen Lewis on March 2, 1933, which quotation reads as follows:

> "Reference is made to your letter of January 25, 1933, requesting a ruling with regard to whether salaries paid to attorneys employed by the Secretary of Banking of the Commonwealth of Pennsylvania, hereinafter referred to as the Secretary, or the Secretary of Banking, are subject to Federal income tax.
>
> In accordance with the provisions of the Banking Act of 1923 of the Commonwealth of Pennsylvania, the Secretary has authority to take possession of the business and property of any bank or trust company which is in unsafe or unsound condition. He is empowered to appoint special deputies or agents to assist him in conducting or liquidating the business or affairs of any corporation or person in his possession. He may also employ such legal counsel as he may deem necessary in the continuation or liquidation and distribution of the assets.
>
> You state that with few exceptions the attorneys designated by the Attorney General, and approved by the Secretary of Banking for legal work in connection with the closed banks, are paid flat annual salaries. The attorneys are not bonded and take no oath. They are designated by letters addressed to them by the Attorney General. The majority of them are paid from the assets of the bank to which they are assigned, although a few are doing general supervisory work are paid by contributions from all closed banks.
>
> In order for the compensation received by an individual from a state or any political subdivision thereof to be exempt from Federal income tax it

must have been received by him as an officer or employee of the state, or a political subdivision thereof, engaged in the discharge of an essential governmental function. An officer is a person who occupies a position in the service of a state or political subdivision, the tenure of which is continuous and not temporary and the duties of which are established by law or regulations and not by agreement. An employee is one whose duties consist in the rendition of prescribed services and not in the accomplishment of specific objects, and whose services are continuous, not occasional or temporary.

It does not appear that these attorneys are officers of the Commonwealth of Pennsylvania or any political subdivision thereof as their duties are not prescribed by statute; they take no oath of office and there is no term designated by statute during which they shall serve.

If the attorneys in question are in the continuous employ of the Banking Department of the state, that is if they are employed by the year to do whatever work is assigned to them by the Superintendent or someone designated by the Superintendent, they are considered employees of the Banking Department, the work of which constitutes the discharge of a governmental function, and their compensation is, therefore, exempt from Federal income tax.

In the cases of attorneys appointed to act in specific cases, who are paid on the basis of the particular work done, they are not considered employees of the State of Pennsylvania or any political subdivision thereof and their compensation is, therefore, subject to Federal income tax on the basis of the decisions in the cases of Metcalf & Eddy v. Mitchell, 269 U. S. 514; Lucas, Commis-

sioner, v. Reed, 281 U. S. 699 (34 Fed. 2nd 263) Commissioner v. Howard, 280 U. S. 526 (29 Fed. 2nd 895) and Blair v. Byers, 35 Fed. (2nd) 326."

There was received in evidence as Petitioner's Exhibit 6 copy of the deficiency notice dated February 12, 1935, which is the basis of this proceeding, and a complete copy of which is attached as Exhibit A to the petition, which is a part of the record herein.

My letter of appointment stated that I would work with the Special Deputy Attorneys General in Philadelphia County in connection with legal matters pertaining to the liquidation of closed banks in Philadelphia County and such other work which they saw fit to assign to me. I immediately reported to those men, and shortly thereafter I was assigned to the regular legal work in connection with two or three of the closed banks that had been taken over within the preceding week, and continuously thereafter I applied myself to that work, which was attempting collection of outstanding indebtedness to the banks and the making of various legal opinions to the Deputy Receivers in Charge. At that time there were no Special Deputies or Special Agents in Charge of banks. I was also asked to take charge of whatever legal matters that came up from surrounding counties. For instance, there were a number of bankruptcies in surrounding counties and I was assigned to take charge of that work, which involved the bringing of suits wherever necessary, consultation with creditors of the banks as well as depositors and stockholders, who came in for information concerning some of those banks, and in general anything that was assigned by the Special Deputy Attorney General at that time. Of course, as time went on there was other work in connection with the banks, such as the procuring of substitute trustees for trust estates, the filing of accounts, preparation of accounts, presenting them in

court, appearance before the Orphans' Court, and in general all matters concerning the liquidation of a considerable number of banks in Philadelphia.

The first work I had related to the Northern Central Trust Company, one of the banks taken over. Subsequent to that I was assigned to the Mortgage Security Company, the Park Trust Company, and the Wharton Trust Company.

For the first three months I received no salary, until the Attorney General had a consultation with the Secretary of Banking to determine just the manner in which our salaries were to be paid. Finally it was determined that my salary would be paid by three banks in the beginning—the Wharton Title and Trust Company, the Park Trust Company and the Mortgage Security Company. However, that did not mean that any work I had started with other banks, such as the Darby Bank and Trust Company, Northern Central, and one or two others, was to be discontinued. I carried on that work just the same, although I received no money from the Northern Central Trust Company, and continued on the work of that bank as well as the Darby until well into the summer of 1934. Subsequent to that time there were a number of other banks, such as the United States Bank and Trust Company, the Central Trust and Savings Company, and others, banks in connection with which the Deputy Receivers thought they could call upon me at any time, rather than upon any of the other members of the Department of Justice staff in Philadelphia County.

The particular work and the particular matters to which I should give attention were determined by the Attorney General's office. My immediate superior in the beginning was Harold Saylor, Deputy Attorney General. The work became so great that the work in Philadelphia was taken over by Special Deputy Attorney General Shippen Lewis. Mr. Saylor was assigned

to the Department of Banking for the entire state of Pennsylvania, and Shippen Lewis took over the work in Philadelphia. His position was Special Deputy Attorney General.

There were a number of other attorneys who held positions similar to mine. There were approximately twenty men in Philadelphia County.

On instructions from the Attorney General's office I handled litigation for the Department of Banking. I entered my appearance as attorney for the Secretary of Banking in possession of the business and property of whatever particular bank it happened to be. In connection with some banks only my appearance was entered. In others I was associated with other attorneys. In some cases we entered our appearances together. In one particular bank I had associated with me Mr. Charles W. Coulston. In other cases I entered my own appearance, depending upon the necessities of the case.

I was free to handle cases according to my own discretion only in very simple matters. I was generally instructed by, or consulted with, first Mr. Saylor and afterwards, Mr. Lewis. From time to time there were sent regular prescribed forms for pleadings, which were established by the Attorney General's office in Harrisburg, and we were instructed to follow them in all our pleadings. Practically all of the papers that were filed in court were in accordance with prescribed forms.

Witness identified three papers as being some of the earlier forms that were submitted for his use. One was called a "suggestion of Record" in connection with the taking over of a particular bank by the Secretary of Banking. It was headed "Appointment of Appraisers," and suggested of record that the Secretary of Banking, who was in possession of the business and property of the company, did appoint

two persons as appraisers of its assets. Another form was for appearances, addressed to the prothonotary of the court, asking him to enter the appearance of (attorney) for the Secretary of Banking, who was in possession of the business and property of the company, and , the Secretary's Special Deputy as Agent.

I received those forms from Harrisburg. Another form had to do with the appointment of the Special Deputy Agent in Charge. All these forms were mimeographed and were decided upon at Harrisburg. We just filled in our names in the blanks. These forms were representative of a large group of forms. We used to get from two or four to six forms a day. I might say that I turned over all my files to my successor in office when I received the letter terminating my services, which required that this be done, and we had to get some of these forms. They are not complete by a long shot. We had to get them from somebody to bring them here today. There was received in evidence as Petitioner's Exhibit 7 the aforementioned three sample forms, marked Form 120-1, Form 120-2 and Form 120-3, respectively.

There was received in evidence as Petitioner's Exhibit 8 a letter dated March 29, 1932, from William A. Schnader, Attorney General, directed to petitioner, reading as follows:

> "There is now in course of preparation by this department a revised code of the banking laws of the Commonwealth for introduction at the next regular session of the Legislature in 1933. Recent experience has shown the necessity of changes in the law for the better protection of the public dealing with banks and trust companies and for more complete control and supervision over the latter by the Department of Banking.

> As attorneys have frequent opportunities to observe the results of unwise, unbusinesslike and even illegal practices on the part of bank officers and directors in State institutions you may have suggestions for amendments to existing laws. I will appreciate any assistance you may give me in preparing the new code and will welcome suggestions from you.
>
> As the work must proceed with due dispatch so that it can be completed by September first this year, I am hopeful that I may receive your suggestions and recommendations in the near future."

I actually rendered some service in connection with an opinion regarding the code mentioned in that letter.

My opinions were subsequently reviewed before being adopted by the person for whom I wrote them, first by Mr. Saylor, and then by Mr. Lewis. Appeals were authorized by the same two gentlemen unless they were in conflict. We were at liberty to draft briefs, but sometimes after we got them back we did not recognize them. They were reviewed by my superiors.

My duties were prescribed by no specific instructions. Generally all the work in connection with the liquidation of the closed banks in the Philadelphia area was under the direction of the Attorney General. I received a continuous stream of written instructions as to them. For instance, when the Home Owners Loan Corporation came into existence, that gave rise to special matters, and immediately we were given instructions about those cases, and also in connection with filing accounts, the making of substitute trustees, etc., all those being matters of general concern to the 165 closed banks in Pennsylvania. All that was decided upon in Harrisburg and the policy they decided upon

was transmitted to us for handling. The method used in giving such instructions was by memoranda prepared by the Attorney General's office, first by the Attorney General himself, and immediately thereafter by a Deputy Attorney General, Harold Saylor, and in 1932 by Special Deputy Attorney General, Shippen Lewis, in connection with Harold Saylor. Witness was handed a package of documents about three inches high and identified the same as just a few of the instructions received. I have looked through those I was able to get hold of and have laid aside a few of them.

There was received in evidence as Petitioner's Exhibits 9 to 18, both inclusive, ten circular instructions, simply as examples of the instructions sent to petitioner by the Department of Justice.

I might add that, in addition to written instructions, which were very minor, we had meetings of all the attorneys every Friday afternoon for the first six months we were assigned to that work, at which time the problems which came up were discussed, and Mr. Saylor, the Deputy Attorney General assigned to the Banking Department, was in charge and he decided the procedure. Anything that arose above an ordinary plain suit on a note was brought into those conferences and was decided by him. Later on the meetings were held twice a month and then once a month.

The Attorney General and the Secretary of Banking between themselves determined how my salary should be divided. It was first divided among three banks, and then four, and then finally from one particular bank. In 1932, from the beginning of the year it was divided among three banks, and at the end of the year, four banks.

I received my salary by check drawn by the Deputy Receiver of the bank, countersigned by the special agent, and signed by the Secretary of Banking in Harrisburg. I got these checks on the first and fifteenth of each month—$125 on the first and $125 on the fifteenth. The several checks aggregated $3000 for the year.

I think that in the beginning of the year it was divided into 17 per cent., 38 per cent. and 45 per cent. Toward the end of the year we got another bank and I think 4 per cent. or 5 per cent. was taken from one bank and put on the other bank. That was no different from all other work in connection with the banks. It was first set by the Attorney General and divided among the different banks. I got the first of those banks.

My $3000 salary covered all the work I did for the department, even though I examined other banks and worked for others than those that were actually contributing to my salary. Toward the end it was just one bank, at the end of 1933.

I had an expense account made up of long distance telephone calls and various other items of that kind. We got instructions as to how to itemize these and submit them to the Special Deputy Attorney General once a month.

I did not use my own letterheads. I used the letterhead of the Commonwealth of Pennsylvania, Department of Justice. I was not permitted to use my own stationery in connection with my official work.

There was received in evidence as Petitioner's Exhibit 19 a letterhead and envelope as a sample of the forms used by petitioner and other attorneys. There is a central heading "Commonwealth of Pennsylvania, Department of Justice" and the imprint of the coat of arms of the State of Pennsylvania.

I was not required to use my own office. We had the necessary facilities. I signed letters "Department of Justice", then my own name, and under it "attorney".

The files relating to my official work were turned over to Mr. Finkelstein, who succeeded me, two days after my employment was terminated.

I was permitted to engage in private practice in my spare time. The department could have required all my time. That work came first all the time. I was forced to give up certain other work I had in Philadelphia at that time. I was operating in an office which had quite an extensive business. I received certain compensation for taking care of certain work in that office. When I received my appointment I could not give it my attention and I was forced to drop all that work. I was not a member of any law firm.

If any work in connection with any particular bank became heavy I could call upon some of the other men in the department. Sometimes they would call on me in connection with an account of affairs. I helped a number of other men prepare their memoranda and briefs. The accounts were not all filed at the same time. Some were filed one month and some another. Even where they were filed together they might have been made at different times.

The character of my employment did not change during the remainder of my term, after 1932 and until the termination of my service in 1935. There was certain special work that came up in the latter part, such as transferring our assets to the Reconstruction Finance Corporation. The method of handling the work was the same.

In 1932 the basic state statute pursuant to which the Department of Banking took over possession of the banks was the Banking Act of 1923 as amended.

That is not the present law. In 1933 the Banking Code was passed. I have referred to the work I did in connection with that code. That superseded the Act of 1923.

Upon cross-examination such witness testified:

It is hard to figure out how much time per day I spent in 1932 on the bank work. There were some days in 1932 that I spent all day and sometimes worked at night. Some of the particular banks I was working on at that time were in various sections of the city and I used to run all over the south part up into the north section and be at my desk to keep appointments at various times. Sometimes I spent the whole day in a bank; sometimes half a day. In 1932 I spent more than 50 percentum of my time in the bank work. That is a conservative estimate. I don't count Sundays. I don't want to exaggerate. I don't count the times I went down on Sundays to prepare briefs.

In 1932, shortly after these banks were taken over, there were depositors coming into those banks each day. Some had balances, some had loans. Questions were coming up that required explanation. I was there at the bank trying to advise these depositors that were anxious to settle. That took a lot of time. A number of banks had trust estates, in one case more than a half million, and in another case $650,000. The heirs came in and wanted to know how they could get their money or how they could get their accounts transferred, or what-not. In answer to the question, "Did you have to get the consent of the Attorney General to give that information to those depositors and other people?" witness testified that on the question of a set-off or something of that kind I couldn't give any information until it was decided what the policy of the department was. The law of Pennsylvania is

somewhat peculiar on the question of set-offs, and there were no decisions of the courts until the early part of 1933, so that the department had to formulate a policy at the beginning of 1932 and we applied that to each particular case. I had authority to advise clients of the banks only when the policy had been established as to the particular matter. If a question arose in a case which was different from the procedure established I told the people to come back a week or two later, and in that Friday conference I raised the question and we discussed it and the policy was decided upon. When they came back the following week I told them.

Mr. Saylor was a full-time Deputy Attorney General who was assigned to the Department of Banking, opened and closed banks and everything else. He rendered official decisions in these conferences, as an official of the Department of Justice. He was authorized to render decisions for the Attorney General in certain matters. In other cases it took sometimes two or three weeks until the conference would have an opinion come back to us. There were a million and one things coming up in these closed banks. There were over thirty-one in Philadelphia County, and millions of dollars involved. It was a pretty tough job we had at the time. Things that were never thought of came up every day.

The Attorney General assigned the particular banks from which we would get our salaries, but under the supervision of Mr. Saylor or Mr. Lewis, if any other work would come up, we would do it.

The Department of Banking had absolutely no authority over me. They did not instruct me as to what banks I was to work. The Attorney General did that. A special agent from the Department of Banking was in control and charge of each of these banks. There

were four or five different special agents or receivers who were directed to come to me for opinions. I was an adviser of those agents in charge.

HAROLD D. SAYLOR, being called as a witness on behalf of petitioner, testified as follows:

I reside at Germantown, Philadelphia, Pennsylvania. I am an attorney-at-law with offices at 123 South Broad Street, Philadelphia. In 1932 I was Deputy Attorney General of Pennsylvania. I was a full-time employee.

The executive branch of the government of Pennsylvania is headed by the Governor, with a cabinet consisting of twenty to twenty-two heads of departments, which are under the administrative division of the government. One is the Department of Justice, headed by the Attorney General. Another is the Department of Banking headed by the Secretary of Banking. The Attorney General had under him at all times at Harrisburg ten deputies and several assistant deputies, and had in different parts of the state special deputy attorneys general. In addition to that he had in nearly every county special counsel to handle special work in that county, and in 1931 he had a total of seventy or seventy-five attorneys acting for him in representing the Department of Banking in connection with the closed banking institutions of the state.

Every one of these attorneys who represented the Department of Banking was directed by the Attorney General himself. There was no attorney in the State of Pennsylvania, acting for the Commonwealth in any capacity or representing any department or any commission, who was not appointed by the Attorney General. It was illegal for any state officer to employ an attorney without the consent and approval of the Attorney General.

When the banks began to close rather rapidly, beginning in the summer of 1931, and continuing at the rate of two or three a day, the Attorney General was faced with a very serious problem to get proper representation for the Department of Banking in taking over these closed banks and trust companies, and he appointed attorneys rather rapidly. He called them in consultation and instructed them in their duties. A large part of that devolved upon me, because I represented the Department of Banking. It was necessary to have someone take my place in charge of the closed banks. I had to be at Harrisburg nine-tenths of the time. I had to go to Philadelphia once a week and there meet with these attorneys, and, as a result of the problems brought before us, we gradually evolved a set of instructions and rules and regulations which were sent to all seventy or seventy-five attorneys.

That work, direct charge of these banks, was placed in the hands of Shippen Lewis, who was designated Special Deputy Attorney General for that purpose. He and I consulted almost daily over the telephone. All the work of those banks in our Department of Justice was kept before the Attorney General by frequent reports. I was with him practically every day. One of the most important things I recall in his instructions in connection with these attorneys or special deputies was that no steps should be taken or opinion rendered on any legal problems involving closed banks without the approval of the Attorney General himself. It was for that reason that we instructed these men not to take positions with respect to matters that were not Hornbook law without getting our position and authority. That was the reason for these frequent discussions with these men.

From time to time cases in which depositors were interested were decided, in relation to various ones of

the sixty-seven counties. We would immediately mimeograph those opinions and send them out to this group of assistant attorneys in advance of their publication in the reports. We also had the attorneys come to Harrisburg, if need be, when particularly pressing problems engaged their attention that had not been decided before. We would consider the facts and determine the policy to be pursued.

In all cases where there was litigation, no steps could be taken without the approval of Mr. Lewis. Whenever there was an appeal from a court of primary jurisdiction to the Superior or the Supreme Courts of Pennsylvania, we insisted that the briefs be sent to Mr. Lewis for his editing, and he would send them to Harrisburg and they would be edited there and printed there.

Sometimes we called in attorneys from different parts of the state to assist us in matters with which they were familiar. I recall very well one attorney occupying a position similar to the one Mr. Freedman had, who, by reason of his experience in appellate matters, was called in to assist us in some litigation that later went to the Supreme Court of the United States. That was true of any and all of these men. It was considered that these men were available for any purpose at any time with the Department of Justice. They were controlled entirely by that department.

In Pennsylvania for a number of years it has been the regular practice and the law that any bank or trust company or private bank or any institution that receives deposits is subject entirely to the supervision of the Department of Banking. There was an exception in respect to certain private banks, such as Drexel & Co. and Brown Bros. & Co. Over every other institution it had complete control as to banking practices and so on. If any of those were found to be in unsound

or unsafe condition, or there was an impairment of capital or surplus or deposits, the Secretary of Banking was charged with the duty and had the authority to take possession of such institutions, and, if he deemed it insolvent, to liquidate its affairs. The law also provided that if any court appointed anybody as a receiver or trustee in bankruptcy, the Secretary, upon application by the Attorney General, could immediately succeed such receiver or trustee. He had complete control and supervision over all banking institutions when they closed. His first job was to send an examiner. If he found the bank was in such shape it should not open, he closed it. These examiners were usually made acting deputies or special agents in charge. As soon as a permanent special deputy could be employed the examiner was returned to his regular duties. This special deputy was authorized to keep such members of the staff of the old bank as he found necessary and when he took charge to safeguard the assets of the closed bank. An attorney was assigned to represent that bank by the Attorney General.

The Banking Department was not at liberty to engage counsel, except those employed by the Department of Justice and assigned to the Department of Banking for that purpose.

"Q. How were the attorneys in your department paid, who were assigned to that work? When were they paid, and by whom?

A. All of the attorneys in the Department of Justice were employees of the Commonwealth of Pennsylvania. All of us in Harrisburg, who represented departments of the government, doing work for the government, were paid out of the state treasury. All the deputy attorneys general were paid from the state treasury. All the deputy attorneys general in the Banking Department, however, the employees, stenographers, clerks and

examiners, and so on, were paid by the state treasurer from a particular fund known as the Department of Banking fund, made up of assessments levied on the open banking institutions and paid to the state treasury to reimburse the Commonwealth. When a bank closed the special deputy who was in charge as a representative of the Department of Banking was expected to pay all the expense of liquidating the closed bank out of the assets of the bank. That included payment of salaries of counsel assigned by the Department of Justice to the bank. (R. 45-46.)

It was at first thought advisable, when they established a fund at Harrisburg to take care of the Department of Banking expenses in connection with closed bank work, to have some central office through which all that work could be cleared and cut down overlapping and effect a more efficient liquidation of the assets. For example, in Philadelphia we had some thirty closed banks. It was obvious that if each deputy operated independently he might be in conflict with other deputies or in competition with other deputies in the sale of real estate, and so forth. Instead of creating a central bureau at Harrisburg, one was created at Philadelphia.

From that fund all salaries were paid. They were paid out of a central fund, but kept separate so far as the assets of the different banks were concerned. It was decided to pay these attorneys out of these funds of the closed banks for which they were working in proportion to the amount of work each one did for the particular closed bank or banks to which he was assigned. They arranged for payment in that manner, and payment was made from the assets of the banks to these attorneys by check drawn on the assets and counter-

signed by the Department of Banking at Harrisburg.

Q. Was there a different procedure in connection with the payment of attorneys engaged in connection with open banks from attorneys engaged in connection with closed banks? (R. 46-47.)

A. Yes; because of the necessities of the situation.

Q. Suppose the assets of some bank to which an attorney was assigned were insufficient to pay his salary, to whom would he look for his salary?

A. He was employed by our department. I suppose we would have to get the money for him somewhere. If the man did the work we would want to pay him.

Q. Do you know of any instances of that kind?

A. I don't recall any during my connection with the Department of Justice at Harrisburg. I ceased that connection on January 15 of this year and have since been in private practice. I do know that a representative of the Secretary of Banking was appointed receiver of the E. T. Wilbur Trust Company, a bank in Bethlehem, by the court, and represented the bank in the reorganization process. It had no assets. He would have to be paid from the general fund at Harrisburg, I expect, in that case.

Q. You say, with respect to the normal operation of the banking department, that is by assessments on banks under its control?

A. Yes.

Q. And you create a special fund?

A. Yes.

Q. Out of which department employees are paid, and attorneys assigned to the Department of Banking? (R. 47-48.)

A. The law provides they shall be paid by the Banking Department. Normally, all salaries

should be paid by the Banking Department for work in behalf of any bank under its supervision, but I presume where a man was working for five or six different banks it might be sometimes difficult to arrive at the proper amount. It is the law of Pennsylvania that all attorneys, as well as special and regular deputies, representing the Department of Banking, shall be paid from that fund made up of assessments upon going concerns under the supervision of the Secretary of Banking.

Q. That fund, out of which these attorneys, like Mr. Freedman, were paid, was under the actual control and supervision of officials of the State of Pennsylvania?

A. No one but the Secretary of Banking or his deputy could transfer or sell any assets of those banks. All cash and mortgages and notes and choses in action were under his supervision.

By THE MEMBER:

Q. The title to the assets was in the banks?

A. No, sir; in the Secretary of Banking. No title was in the bank when it closed. Title to all the property of a closed bank was taken in the name of the Secretary of Banking, William D. Gordon.

Q. Taken in trust for the creditors and stockholders of the bank? (R. 48-49.)

A. Exactly.

Q. And not in trust for the Commonwealth of Pennsylvania?

A. Oh, no. It was for the benefit of depositors and creditors.

By MR. TOWNSEND:

Q. But wasn't it true that, to the extent that the Department of Banking had assets subject to administrative expense, it asserted a prior claim in behalf of Pennsylvania?

A. Absolutely, and had to under the law.

Q. That was in effect an assessment on the assets which was appropriated to the salary of Mr. Freedman and other like employees, just the same as a fund created by an assessment against live banks was appropriated for expenses of the department?

A. I would say yes, except there were different funds, whereas at Harrisburg there was no other fund.

By The Member:

Q. That assessment on open banks was pursuant to the law?

A. Yes, sir.

Q. These assessments were paid into the state treasury?

A. Yes, sir.

Q. And became a part of the funds of the State of Pennsylvania?

A. Yes, sir. (R. 49.)

Q. And were taken from those funds by the appropriation?

A. No, sir; it didn't become a part of the general fund of the State of Pennsylvania. It became a part of the special fund of the State of Pennsylvania known as the Department of Banking fund. It was from that fund that all expenses of the Department of Banking were paid. I think the reason for that was they didn't want to be in the embarrassing position some time of having to make a good many examinations of banks and banking institutions and not having the appropriation with which to do it. If they had a special fund they could immediately send out examiners to take charge of the banks and the funds, and they could be built up again.

Q. Was the fund in different percentages, or was it in the same amount?

A. It was a definite fund in the hands of the Secretary of Banking.

THE MEMBER: Go ahead, Mr. Townsend.

By MR. TOWNSEND:

Q. Was there any particular reason why the same fund was not used in connection with closed banks?

A. There may have been a reason that they didn't consider that open banks should bear the expense of taking care of closed banks. As far as the expense is concerned, they didn't want to have the extra expense of maintaining another fund at Harrisburg and have the Treasury Department burdened with extra details that would be necessary by paying it through the Harrisburg fund. (R. 50-51.)

Q. The difference in the schemes used in paying attorneys assigned to closed banks and open banks was just a matter of convenience and economy of operation?

A. It was that they accepted the difference between a closed and open bank. "I don't see any reason why they didn't have two different funds, one for closed banks and one for open banks. There is no difference in principle at all." (R. 51.)

WHEREUPON the petitioner's case was closed.

The respondent produced no witnesses in his behalf. There was received in evidence, as Respondent's Exhibit A, an interoffice memorandum dated November 30, 1934, from L. K. Sunderlin, Chief of the Rules and Regulations Section of the Income Tax Unit, Bureau of Internal Revenue, and approved by Deputy Commissioner Russell to Mr. H. B. Robinson, Head of the Audit Review Division, reading as follows:

"Reference is made to your memorandum of October 26, 1934, requesting a ruling in regard to whether the compensation received by Clarence M. Freedman, Philadelphia, Pennsylvania, in 1932 for services rendered to the Department of Banking of the Commonwealth of Pennsylvania in connection with the liquidation of banks taken over by that Department, is exempt from Federal income tax.

It appears that Mr. Freedman was appointed by the Department of Justice of the Commonwealth of Pennsylvania in 1932 at a salary of $3,000.00 as an attorney and assigned to do liquidation work in the Department of Banking. It is stated that each attorney so appointed is required to take an oath of office and is subject to the supervision of the special district attorney in charge of the bank to which the appointee is assigned and indirectly to the Attorney General of the state. It is stated that in some instances the salaries are assessed directly against the bank for which the work was done and in other instances they are paid from a gross assessment made against all banks in the area.

In order for the compensation received by an individual from a state or any political subdivision thereof to be exempt from Federal income tax it must be determined that it was received by him as an officer or employee of the state or political subdivision and that to subject it to Federal income tax would so burden the state or political subdivision as to constitute an interference through taxation by the Federal Government with the discharge by the state or political subdivision of an essential governmental function.

In G. C. M. 13488, I. R. B. XIII, 35, page 9, it is held that liquidators who are appointed to liquidate banks taken over by the state in Florida whose

compensation is paid from funds or assets of the bank being liquidated is subject to Federal income tax. In that decision it is stated:

> " . . . He was clearly not an officer of the State, and there is basis for the view that he was not an employee within the meaning of that term. If, however, it should be established that he was an employee of the State, it is certain that a tax upon his income cannot be deemed to be an interference with Government, or an impairment of the efficiency of its agencies in any substantial way. No such interference could result with respect to this taxpayer since the compensation was not paid by the State but by the bank which was being liquidated.
>
> In Miller v. McCaughn (22 Fed. (2d) 165), the United States District Court, in holding that the compensation received by an auditor appointed by the Pennsylvania State courts to report on the financial standing of corporations applying for approval as sureties on bonds, was not exempt from Federal income tax, stated:
>
> > " . . . The compensation must not merely come to a State officer or employee but it must come to him from the State to be exempt. Unless this second line is drawn and drawn where we have drawn it, it is difficult to determine where it should be drawn. A moment's thought will bring to mind scores of instances in which the respondent might well be held to be such 'officer or employee' but in which the compensation does not come directly or indirectly from the State, otherwise

than in the sense that he would not be in the enjoyment of it, were it not for the relation of officer or employee of the State which he enjoys.

Here what the plaintiff receives comes wholly from the surety companies upon whose financial resources he reports. . . .''.

In view of the foregoing it is held that the compensation received by Mr. Freedman for services rendered to the Department of Banking of the Commonwealth of Pennsylvania must be included in gross income for Federal income tax purposes.''

The foregoing is all of the evidence material to the Assignment of Errors adduced at the hearing before the United States Board of Tax Appeals and the same is approved by the undersigned, as the attorneys for the respective parties to this proceeding.

(Sgd.) JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

(Sgd.) MORRISON SHAFROTH,
Attorney for Respondent on Review.

The foregoing is all of the evidence adduced at the hearing, which is material to the assignment of errors set forth in the petition for review filed by the petitioner herein, and in order that the same may be preserved and made a part of the record, this statement of evidence is duly approved and settled this sixteenth day of December, 1936.

(Sgd.) C. R. ARUNDELL,
Member, United States Board of Tax Appeals.

PRÆCIPE.

(Filed December 16, 1936.)

To the Clerk of the United States Board of Tax Appeals:

You are requested to prepare and transmit to the clerk of the United States Circuit Court of Appeals for the Third Circuit a certified copy of the record in the above-entitled case, including therein copies of the following:

1. Docket entries of the proceeding before the Board.

2. Pleadings before the Board:

(a) Petition, including annexed copy of deficiency letter and statement attached thereto;

(b) Answer.

3. Findings of fact and opinion of the Board promulgated August 19, 1936.

4. Decision or order of redetermination entered August 21, 1936.

5. Petition for review and assignment of errors.

6. Notice of filing petition for review and assignment of errors with proof of service of said notice and the said petition.

7. Statement of evidence.

8. This præcipe.

JOHN W. TOWNSEND,
Attorney for Petitioner on Review.

Service of a copy of the foregoing præcipe is hereby acknowledged. Agreed to.

MORRISON SHAFROTH,
Attorney for Respondent on Review.

CERTIFICATE.

UNITED STATES BOARD OF TAX APPEALS,
WASHINGTON.

DOCKET No. 79424.

Clarence M. Freedman,
Petitioner,

v.

Commissioner of Internal Revenue,
Respondent.

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 50, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the præcipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this thirtieth day of December, 1936.

B. D. GAMBLE,
(Seal) *Clerk, United States Board of Tax Appeals.*

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the Board of Tax Appeals

And now, to wit: This 28th day of April A. D. 1937, it is ordered that Hon. Oliver B. Dickinson, District Judge for the Eastern District of Pennsylvania, be and he is hereby assigned to sit in above case in order to make a full court.

JOSEPH BUFFINGTON, *Circuit Judge.*

(Endorsements:) Order Assigning Hon. Oliver B. Dickinson for Argument Received & Filed Apr. 28, 1937. William P. Rowland, Clerk.

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

And afterwards, to wit, the 28th day of April, 1937, come the parties aforesaid by their counsel aforesaid, and this case being called for argument sur pleadings and briefs, before the Honorable Joseph Buffington and Honorable John Biggs, Jr., Circuit Judges, and Honorable Oliver B. Dickinson, District Judge, and the Court not being fully advised in the premises, takes further time for the consideration thereof,

And afterwards, to wit, on the 23d day of August, 1937, come the parties aforesaid by their counsel aforesaid, and the Court, now being fully advised in the premises, renders the following decision:

In the United States Circuit Court of Appeals for the Third Circuit

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Petition for Review From the United States Board of Tax Appeals

Opinion

Filed August 23, 1937

Before BUFFINGTON and BIGGS, Circuit Judges, and DICKINSON, District Judge

BUFFINGTON, J.: This is an appeal by the taxpayer from an order of the federal tax board assessing income tax against him, and the question involved is: "Was the annual salary of $3,000 received by petitioner in 1932 for services rendered as an attorney in the Department of Justice of the Commonwealth of Pennsylvania exempt from the Federal Income tax?" The facts, which are not in dispute, are thus stated by the Tax Board:

"The department of justice and the department of banking are administrative divisions of the Commonwealth of Pennsylvania. The head of the department of justice is the attorney general and the head of the department of banking is the secretary of banking, these offices being provided for by statute. The attorney general has statutory power 'to appoint and fix the compensation of Special Deputy Attorneys General and Special Attorneys to represent the Commonwealth, for any department, board, or commission thereof, in special work or in particular cases.' Purdon's Penna. Stats., title 71, Sec. 296. The secretary of banking is by statute given broad powers over banks within the commonwealth. When it appears to him that a bank is in an unsafe or unsound condition he may, after notice and hearing and with the consent of the attorney general, take possession of the business and property of the bank; under certain conditions he may take possession without hearing and without the attorney general's consent. When he takes possession of a bank, he is vested with 'all the rights, powers, and duties of a receiver appointed by any court of equity in this Commonwealth;' while in possession of the bank he is 'the representative of the creditors thereof.' The banking law provides that, in the case of banks the property of which is in the possession of the secretary of banking, all expenses in connection with such possession and of continuing the business or of liquidation 'shall first be payable out of the funds of' such bank 'including the compensation of special deputies, assistants, and others employed by the Secretary to assist him in such proceed-

ings; the allowances of all such expenses to be subject to the approval of the Court.' Purdon's Penna. Stats., title 7, Sec. 29, 49.

"The petitioner was assigned to work under special deputy attorneys general in Philadelphia County in connection with legal matters pertaining to closed banks in that county. Such closed banks were being liquidated by the secretary of banking pursuant to statute. The petitioner's duties consisted of attempting to collect debts due such closed banks, rendering legal opinions to the deputy receivers in charge thereof, handling the legal matters for the banking department that came up from surrounding counties, prosecuting suits in court, consulting with creditors, depositors, and stockholders of closed banks concerning their claims, procuring substitute trustees for trust estates being administered by such banks, preparing, filing, and presenting accounts in the Orphans' Court, preparing data in connection with the proposed state banking code, and 'in general anything that was assigned by the Special Deputy Attorney General at the time.' Such attorneys were considered by the department of justice as 'available for any purpose at any time.'

"The petitioner handled legal matters for the state banking department in connection with the liquidation of the Northern Central Trust Co., the Darby Bank & Trust Co., the United States Bank & Trust Co., the Central Trust & Savings Co., the Mortgage Security & Trust Co., the Park Trust Co., and the Wharton Trust Co., among other closed banks in the Philadelphia area. The petitioner was one of approximately twenty lawyers assigned to like work in Philadelphia County.

"The particular work and the matters to which the petitioner gave attention were determined by the attorney general's office. He was free to use his discretion only in simple matters. In regard to all proposed litigation and appeals, he was required first to consult with his superior officers. He was required to follow prescribed forms issued by the attorney general's office as to preparation of documents and pleadings. His legal opinions were reviewed and often revised by his superiors before being issued. Likewise, briefs were reviewed and frequently entirely redrafted. All matters of policy in particular cases were decided by the attorney general and his deputies. The petitioner's advice to depositors of closed banks was limited to matters on which his superiors had ruled. All such attorneys were instructed to take no steps and render no opinions on any legal problem involved in closed banks without approval of the attorney general.

* * * * * * *

"The petitioner received no compensation for his services other than his $3,000 salary, but was reimbursed for his expenses. He was furnished with necessary office facilities. He was required to use official letterheads furnished by the department of justice, and signed his letters as 'attorney' for the department of justice. The files in matters handled by him were considered the property of the state

and were turned over by him to his successor when his employment was terminated. While the department of justice could have required all his time and had first call on his services, he was permitted to engage in private practice. In 1932 he spent more than 50 percent of his time on state business. He had to give up certain regular employment to accept the employment in the department of justice. His professional income for 1932, aside from the $3,000 salary, was $2,735.60. He was not a member of a law firm.

"Petitioner's salary was paid to him semi-monthly by checks drawn by representatives of the state banking department in charge of closed banks in Philadelphia, the checks being countersigned by the secretary of banking at Harrisburg."

The taxpayer paid income tax on the $2,735.60, his professional income. He claims his salary of $3,000 was exempt.

In pursuance of the statutory authority noted above, "to appoint and fix the compensation of Special Deputy Attorneys General and Special Attorneys to represent the Commonwealth, for any department, board, or commission thereof, in special work or in particular cases," the Attorney General of the State of Pennsylvania, on October 2, 1931, notified the taxpayer that "it gives me pleasure to appoint you an attorney in this Department assigned to the liquidation work of the Department of Banking. Your salary will be at the rate of $3,000.00 per annum. The Special Deputy Attorneys General who are assigned to this work in Philadelphia are being advised of your appointment and that you will be available to assist them in any way in which they may find it necessary to call upon you."

The uncontradicted testimony of the taxpayer was that "the Department of Banking had absolutely no authority over me. They did not instruct me as to what banks I was to work. The Attorney General did that. "The Deputy Attorney General testified: "It was considered that these men were available for any purpose at any time with the Department of Justice. They were controlled entirely by that department." In view of this uncontradicted evidence, we hold it proven that the taxpayer was an employee of the State acting by its Attorney General. Moreover, it will be noted that the Tax Board made no finding that he was not an employee of the State, but in that regard limited itself to the negative statement, "we are not satisfied that petitioner can properly be classified as an employee of the Commonwealth of Pennsylvania." Being an employee of the State or the Nation, being engaged in recognized governmental work—in this case the vital Department of Banking (Therrell v. Commissioner, 88 Fed. (2d) 869)—it follows that the quantum of the employee's pay, the means by which he is paid, are features which do not on the one hand determine the liability of the national employee to state taxes or the state employee to federal taxes. The Nation and the State, within their respective spheres of governmental administration, are not subject to taxation imposed by other sovereignties. Within their own province, they are

exempt from—to them—alien burdens in the way of taxation. Indian Motocycle Co. v. United States, 283 U. S. 570.

The same constitutional principle that prevents the State of Pennsylvania from taxing the income of special attorneys of the United States equally prevents the United States from taxing the income of special attorneys of the Commonwealth of Pennsylvania. As the national banks are "instrumentalities, means, and operations" whereby the Federal Government exercises a governmental control over them, so the state exercises like governmental control over state banks, for, as said in 283 U. S. 570, "this principle is implied from the independence of the national and state governments within their respective spheres and from the provisions of the Constitution which look to the maintenance of the dual system."

So regarding, and without discussing the elaborate arguments and citations of the respective parties—all of which have been duly considered—we limit ourselves to setting aside the order of the Tax Board. This view is in line with the decisions of this Circuit in Commissioner v. Coughlin, 87 Fed. (2d) 670, and Commissioner v. Hindman, 88 Fed. (2d) 44.

A true Copy:
Teste:

Clerk of the United States Circuit Court of Appeals for the Third Circuit.

In the United States Circuit Court of Appeals for the Third Circuit

No. 6327. March Term, 1937

CLARENCE M. FREEDMAN, PETITIONER

vs.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Appeal from the United States Board of Tax Appeals

This cause came on to be heard on the transcript of record from the United States Board of Tax Appeals, and was argued by counsel.

On consideration whereof, it is now here ordered, adjudged, and decreed by this Court that the order or decree of the said Board of Tax Appeals in this cause be, and the same is hereby reversed.

Philadelphia, August 23, 1937.

Per Curiam:

BUFFINGTON, *Circuit Judge.*

(Endorsements:) Order Reversing Decree Received & Filed Aug. 23, 1937. William P. Rowland, Clerk.

UNITED STATES OF AMERICA,
Eastern District of Pennsylvania, Third Judicial Circuit, Sct:

I, Wm. P. Rowland, Clerk of the United States Circuit Court of Appeals for the Third Circuit, do hereby certify the foregoing to be a true and faithful copy of the original Transcript of Record and proceedings in this Court in the case of Clarence M. Freedman, petitioner, vs. Comr. of Internal Revenue, respondent, No. 6327, on file, and now remaining among the records of the said Court, in my office.

In testimony whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Philadelphia, this 4th day of November, in the year of our Lord one thousand nine hundred and thirty-seven and of the Independence of the United States the one hundred and sixty-second.

WM. P. ROWLAND,
Clerk of the United States Circuit Court of Appeals, Third Circuit.

Supreme Court of the United States

Order allowing certiorari

Filed December 6, 1937

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit is granted, and the case is assigned for argument immediately following No. 287.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.